Audit says Md. losing revenue

Property owners get improper tax breaks; out-of-state firms not paying required fees

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Thousands of property owners might be getting improper tax breaks on second homes and rental properties, and more than 1,100 out-of-state companies might be doing business in Maryland without registering or paying required fees, according to a legislative audit released yesterday.

The state is instituting a new application procedure to ensure that Maryland residential property owners get homestead credits - which limit annual property tax increases - only on their principal residences, as the law requires.

"You don't want somebody who is renting a property out to be getting the Homestead Tax Credit," said Robert E. Young, associate director of Assessments and Taxation. "It's for the principal residence, and that's what it's designed to do."

According to the audit, conducted by the Office of Legislative Audits, one unidentified county found more than 1,000 cases of property owners who appeared to be enrolled more than once. The county found that 63 percent of those subject to a follow-up audit were ineligible for the tax break. The auditors also checked 25 rental properties listed on the Internet this spring. Fifteen were classified as principal residences in state records. After subsequent investigation, the state Department of Assessments and Taxation booted eight of them from the program.

It was unclear how much local and state governments might be losing from homeowners improperly claiming multiple homestead exemptions or from other issues that auditors identified in their examination of the Department of Assessments and Taxation. But state officials vowed to make sure that the state is getting all the tax revenue it is due.

"If anyone has a suggestion that has a possibility of producing additional revenue for the state or can improve a system that's out there, then we're ready to accept it and go for it," Young said.

Taking action

The department also plans to use data from the Maryland comptroller's office to crack down on out-of-state companies that haven't registered here but still have active sales tax accounts or contracts with the state. Officials said they are exploring legal avenues to force the companies to pay the fees or stop doing business in Maryland.

In addition, the department plans to investigate a wide disparity in eight Maryland counties between the assessments of commercial properties and the actual market values as determined by sales. In some jurisdictions, the assessments averaged as little as 52 percent of the sales price.

State officials said the increasing use of a tax loophole that is under scrutiny by Gov. Martin O'Malley and legislative leaders might have contributed to that disparity.

The report by the Office of Legislative Audits comes as Maryland grapples with a projected $1.5 billion budget shortfall next fiscal year. Most of the discussion on how to balance the budget has focused on higher taxes, lower spending and expanded gambling, but officials from the governor on down say that more rigorous tax collection could help chip away at the problem.

One change coming for many Marylanders will be a requirement that homeowners submit applications with information that includes their Social Security numbers to maintain their homestead tax credits.

The credits, which saved homeowners about $540 million in state and local taxes last year, are supposed to apply only to primary residences. But without records of homeowners' Social Security numbers, the state has no way to check whether individuals are claiming more than one primary residence.

To fix that, the department pushed for a new law that passed unanimously during this year's General Assembly creating the application process. The department plans to begin by sending applications to homeowners whose residences are being reassessed this year - each property is reassessed every three years - starting Jan. 1. Homeowners who do not respond within 60 days will be removed from the program.

Ensuring compliance with the law could mean some added money for the state, but the real impact would likely be felt on the county level, where most property taxes are collected. The state property tax rate is 11.2 cents per $100 in assessed value, but the majority of a homeowner's bill goes to local government. Local rates range from 89.1 cents per $100 of assessed value in Anne Arundel County to $2.268 per $100 in Baltimore City.

Furthermore, the homestead program provides a stronger brake on county revenues than state revenues. The credits prevent a homeowner's state property tax bill from increasing by more than 10 percent in a year because of higher tax assessments. But counties and cities set their own caps, and in the Baltimore area, they tend to be more strict than the state standard.

In Baltimore City and County, the cap is 4 percent, in Howard, 5 percent, and in Anne Arundel, 2 percent.

Anne Arundel County Budget Officer John Hammond said his county's property tax cap is structured differently from those of other jurisdictions, so rooting out homestead credit scofflaws would not provide a tax windfall there. In most counties, the cap applies only to increases in individuals' bills, but in Anne Arundel, it also limits the amount by which total property tax revenue can grow. But even in Anne Arundel, it could mean lower bills for people who play by the rules, he said.

"As far as individuals are concerned, their tax bills could be influenced by the fact that there are too many people out there getting homestead credits that shouldn't be getting it," Hammond said.

Uncovering offenders
Until the new application procedure is fully in place, it will be impossible to tell how many property owners are enrolled in the program more than once. But anecdotal evidence suggests that thousands might be double-dipping.

Uncovering the number of out-of-state businesses operating illegally in Maryland could prove trickier, Young said. There are minimum thresholds for how much a business needs to do in Maryland to register. Selling a CT scan machine to the University of Maryland, for example, would not be enough, but holding a service contract with the state for two years in a row would, he said.

Auditors estimated that companies identified in this and previous audits could owe the state as much as $1.1 million in registration fees and penalties. But Young said auditors used a wide screening mechanism to identify potential scofflaws and that the actual number of affected corporations would likely be much lower than the 1,100 figure that auditors identified. Nonetheless, Young said the department will increase its scrutiny of out-of-state companies.

Maryland Chamber of Commerce spokesman William Burns said in-state businesses would be eager to see it.

"It's a crime to do business in the state if your charter has been forfeited, and in fairness to Maryland's good corporate citizens, like our members, we feel the department should throw the book at the lawbreakers," Burns said.

But the chamber is not so keen on one of the department's theories for why commercial assessments are lagging behind sales prices in certain counties.

Bill Stansbury, the department's deputy director, said the problem that auditors identified is mostly the result of a nine-month lag between the assessments and sales data that auditors examined.

But Stansbury said the department is facing a broader problem: Rather than selling commercial property outright, businesses are making the properties part of limited liability corporations and selling those companies. That prevents the sale from generating Maryland transfer taxes, and Stansbury said the sale price of the property becomes invisible to the state, making it more difficult to assess commercial properties based on comparable sales.

"Our bread and butter are sales," Stansbury said. "This is data we need to help us better do our job."

House Speaker Michael E. Busch has been pushing for years to close that loophole, and O'Malley has said recently that he will support such an effort.

But Burns said that theory can't explain the differential. Statewide, the ratio of assessed value to sale price is essentially the same for commercial properties as for residential properties, he said, meaning that the problem lies in the assessment practices of the eight counties that auditors identified, not in state laws governing property sales.

"There is adequate sales data to assess commercial properties at market value," Burns said. "It's a matter of management within the department to figure out what's different in these counties."

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